Estimating the effects of fully phased-in Earned Income Tax Credit (EITC) on the decline in welfare caseloads between 1994 and 2000

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There has been a dramatic shift in U.S. social welfare policy in the 1990s. Diverting from helping non-working families in the past, a new focus has been placed on assisting low-income working families with children. This significant change was accompanied by a nearly fifty percent decline in Aid to Families with Dependent Children (AFDC), which was replaced with Temporary Assistance to Needy Families (TANF). The Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996 that enacted TANF at a national level was the culmination of the nation's effort to move families on assistance off welfare to self-sufficiency through work.

While most policy analysts have attributed this decline to the success of welfare reform, some scholars have pointed out the fact that the substantial decline occurred before these newly implemented welfare policies came into effect and/or before welfare recipients reached the time limits. Several studies have examined why such an unprecedented decline in the AFDC/TANF caseloads occurred after 1994, when caseloads reached its highest point since 1960 (The Brookings Institute, 2001). These previous studies attributed the decline in the welfare caseloads during the 1990s primarily to the adoption of federal AFDC waivers, TANF, and a booming economy (Blank, 1997; CEA, 1997, 1999; Moffitt, 1999; Ziliak et al., 2000).

However, the previous studies overlooked an important change in U.S. family policy in the 1990s—the series of expansions of the Earned Income Tax Credit (EITC). In particular, the Omnibus Budget Reconciliation Act (OBRA) in 1990 and 1993 significantly increased credit rates and the EITC's maximum benefit and expanded income eligibility limits. OBRA 1993 required that the EITC be fully phased-in by 1996, and as a result, the fully phased-in EITC has become the largest benefit program for low-income working families with children in the United States (see Table 6A.1 of Scholz and Levine, 2001, for complete data).

Moreover, the success of the federal EITC has led a number of states to enact state EITCs that supplements the federal EITC. Altogether, 15 states and the District of

Columbia now offer state EITCs based upon the federal credit rate.[1] As previous research supports, state EITCs are well-targeted work incentive programs that reduce poverty among children by subsidizing low wages in the form of a refundable tax credit. Therefore, state EITCs are also expected to have substantially contributed to declining welfare caseloads in the 1990s.

The primary objective of this study is to estimate the effect of the fully phased-in EITC on welfare caseloads, controlling for other policy, demographic, and political factors. The EITC provides people incentive to enter the labor market and increases low-income workers' combined disposable income from both wages and EITC subsidy. This study, thus, hypothesizes that the federal EITC helped the low-income workers to leave welfare rolls. In addition, this study estimates the potential effect of the EITC on welfare caseload reduction under the assumption that the EITC have sustained purchasing power. Secondly, this study hypothesizes that the adoption of state EITCs also contributed to the decline in the welfare caseloads in the 1990s. Thirdly, the study examines what role the variation in waiver and TANF policies has played in welfare caseload trends. This study, which includes data from more years than the previous studies, attempts to examine how state variations in work-enforcement provisions affect the welfare caseloads in the longer run.

This study employs a panel of annual state caseload data from 50 states and the District of Columbia between 1994 and 2000. The major data source for this study was taken from the Technical Report of the Council of Economic Advisors to the President in 1999. Combining cross-section and time-series data, the fixed-effects model is used to examine the factors associated with the reduction in welfare caseloads from 1994 to 2000. To separate the effects of the EITC from the compounding effects of other factors on the welfare caseloads, this study controls for state policy variations in federal AFDC waivers as well as in TANF, business cycle, demography, and political influence in each state in each year. To estimate the precise impact of the EITC on caseloads, this study also controls for state-specific effects as well as time-specific effects.

Results of this study support that, holding other factors constant, it is estimated that a one percent increase in the EITC phase-in rate (families with 2 or more children receive 40 cents for additional dollar earned if their incomes is less than $9,700 in 2000) is associated with a 1.2 percent decrease in caseload rate, as the results from the basic model show. This means that the federal EITC would have moved nearly 722,525 people off welfare on the national average in any given year from 1994 to 2000. The results from the simulation showed that the EITC could have been more effective in lowering welfare caseloads, should the EITC have sustained against erosion of purchasing power.

The state EITCs are also estimated to be effective for reducing the welfare caseloads. This result indicates that the state EITCs can be an effective tool for helping people move off welfare by supplementing low-income workers' disposable income and could decrease welfare caseloads considerably.

The results of the impact of work enforcement provisions of welfare reform under AFDC waivers and TANF indicate that states with harsher sanctions (full sanctions) and

[1] Federal credit rate depends on where a family's income falls in the 3 different income ranges. Currently, the maximum subsidy rate is 40% of an eligible family's earned income.

time limit/work requirements would have contributed to the decline in the caseloads from 1994 and 2000. On the other hand, states with more lenient rules on work provisions seem to have an impact on welfare caseloads to a lesser extent. However, higher earnings disregard and family cap provisions did not show a statistically significant relationship with welfare caseloads.

This study has several implications. First, findings support that the EITC could help single mothers move off welfare by making work more attractive alternative to welfare receipt. Second, as shown in simulation of the EITC phase-in rate, maintaining an adequate EITC subsidy rate is essential to keep it consistent with the cost of living. By supporting work efforts through the EITC, the government can send a stronger message to welfare recipients that work rewards. Third, adopting state EITCs is also an effective tool when combined with the federal EITC to help low-income working families with children by increasing their earnings and reducing welfare caseloads. Fourth, given the significance of the EITC's role in families' economic well-being, social workers need to learn swift changes not only in the new welfare programs and eligibility rules but also in the legislation. Integrating such curriculum into social work education will be timely and appropriate. Social workers need to learn how legislation is being made and how much impact legislation can have on the people that they work with daily. This way, social workers may be able to provide leadership in informing the public to help state and local decision makers carry out their new responsibilities more effectively.

Lastly, it is essential to note that while the EITC is an effective instrument to fight poverty while providing work incentives, we should be mindful of the fact that the EITC does not help the children in the most destitute families, such as those with nonworking parents. Therefore, the EITC cannot replace the safety net. A more universal approach to support *all* needy families with children should be considered.

Much still remains unknown about how the devolution of welfare policy has affected the well-being of American children. The caseload studies do not answer under what conditions these children have been living after the families left welfare rolls. Future research should answer under what circumstances and with what types of state policy options the families and their children fare better after leaving welfare rolls.

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